Gourinchas and Martin

The Economics of Sovereign Debt, Bailouts, and the Eurozone Crisis

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A Nice Paper

How the holdup problem shapes sovereign debt arrangements

Discussion

- Ex post
- Ex ante

Ex Post

(Throughout, let $\alpha^{i,i} = 0$, $\rho = 0$, $\pi = 0$, $\Phi = 0.5$, $y_1^g = 1$)

Optimal default choice

- i, absent transfer: default if $b_1^i > y_1^i \Phi$
- EU ($i \cup g$): default if $\alpha^{i,u} b_1^i > y_1^i \Phi + \kappa$

Coase

- In case of conflict, transfer $\kappa + \alpha^{i,g} b_1^i$ (at least)
- Make i internalize social loss κ
- Make i internalize that $\alpha^{i,g} b_1^i$ is just transfer

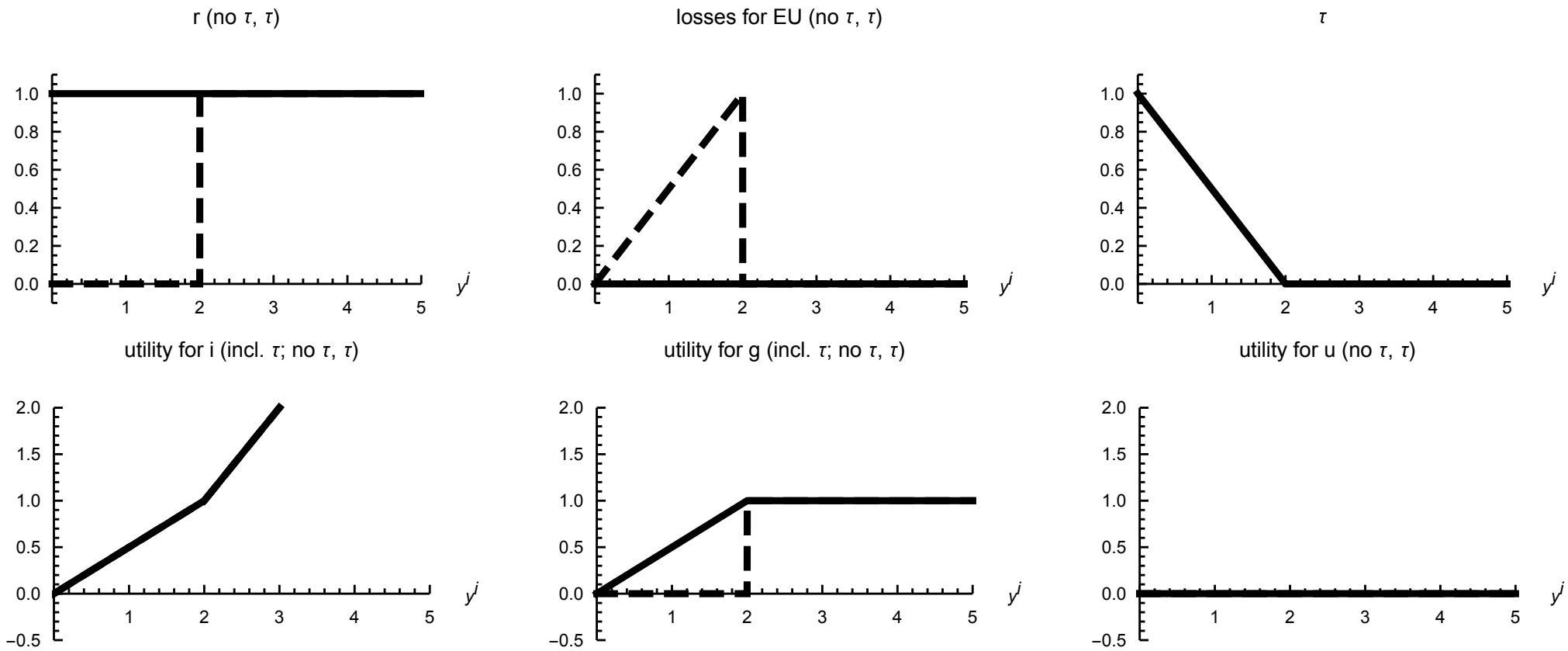

Figure 1: $b_1^i = 1, \alpha^{i,u} = 0.0, \alpha^{i,g} = 1.0, \kappa = 0.0, \xi = 0.0$

Ex Post: Comments

"Southern view"

- G/M assume g receives all surplus
- Could assume opposite
- Model assumes rather than explains "Southern view"

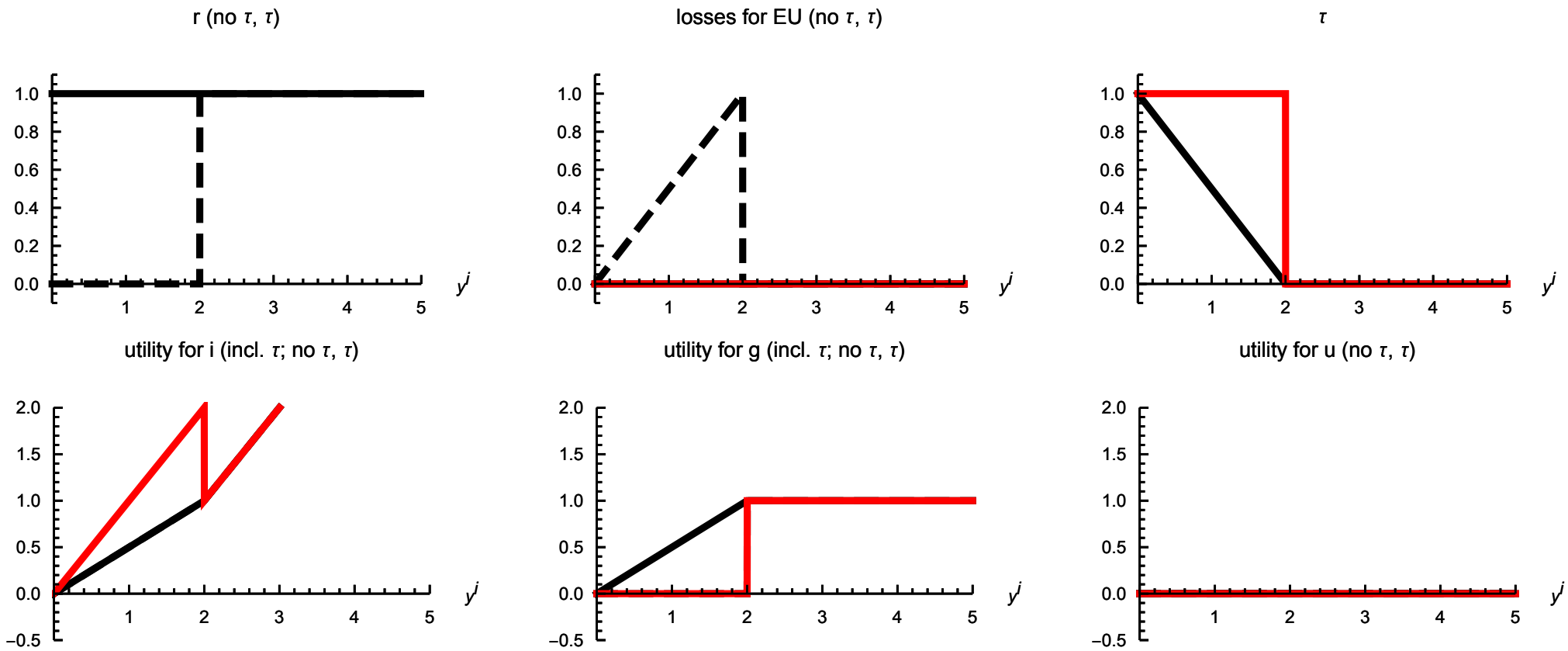

Figure 2: $b_1^i = 1, \alpha^{i,u} = 0.0, \alpha^{i,g} = 1.0, \kappa = 0.0, \xi = 1.0$

Role of κ

- κ not important for τ

  $\alpha^{i,g} > 0$ & $\Phi > 0$ suffices (see previous example)

  What's needed: i incentives $\neq$ EU incentives (g is pivotal)

- But, κ important for result less emphasized

  With $\alpha^{i,u} > 0$, $\kappa > 0$ induces transfer from g to u

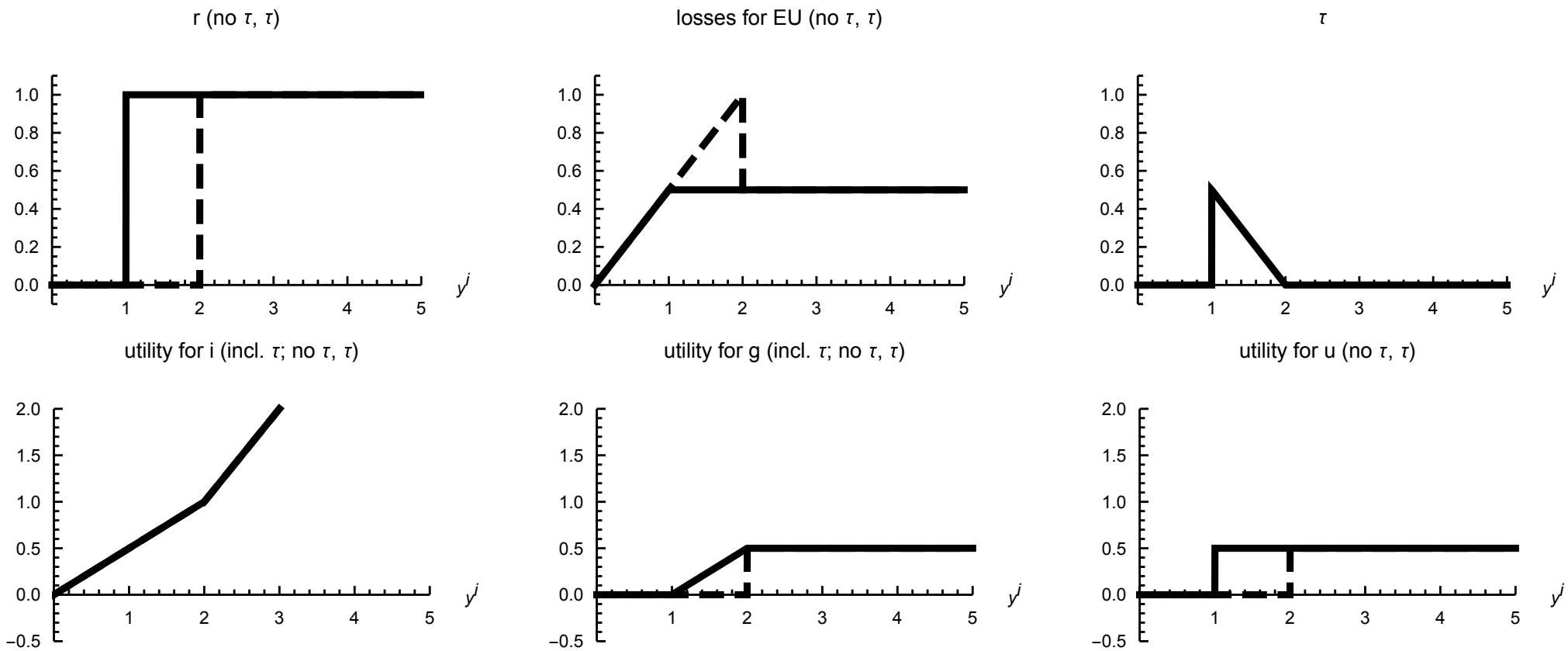

Figure 3: $b_1^i = 1, \alpha^{i,u} = 0.5, \alpha^{i,g} = 0.5, \kappa = 0.0, \xi = 0.0$: We are taken advantage of by every nation in the world virtually

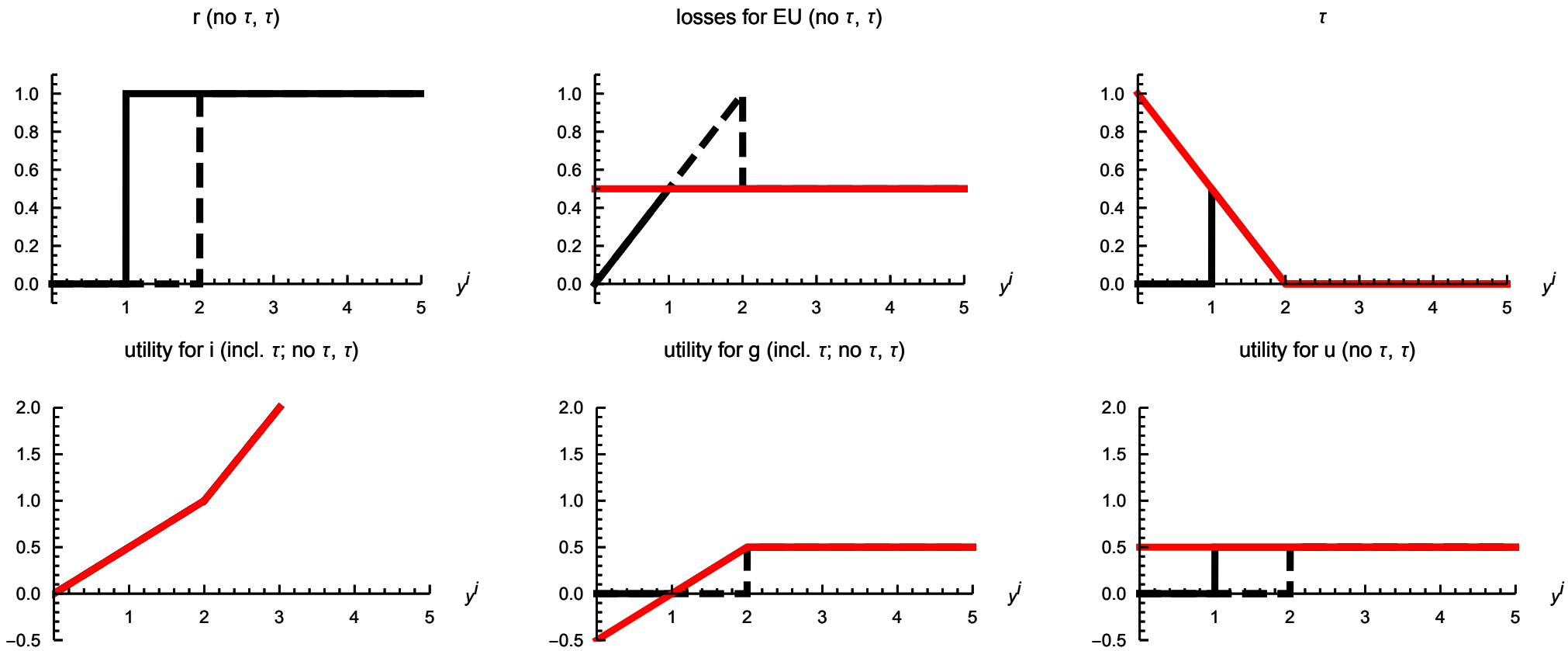

Figure 4: $b_1^i = 1$, $\alpha^{i,u} = 0.5$, $\alpha^{i,g} = 0.5$, $\kappa = 0.5$, $\xi = 0.0$: Making u great again through $i \cup g$ integration

More on κ

- Plausible that κ unrelated to $\alpha^{i,g} b_1^i$?

  i's debt vis-à-vis anybody empowers i vis-à-vis g

- Interpretation as "collateral damage" too narrow

  κ could reflect social loss born by g investors, not third parties

  Cross-border resolution regimes—aiming to eliminate collateral damage—do not help

  Important

Ex Ante

i issues b_1^i to small lenders in g, u, s.t. RE

- b_1^i risk free beyond $y_1^i \Phi$, due to soft budget constraint
- Old and new determinants of b_1^i
  Gains from trade, absent due to linearity and "$\beta = \delta$"
  Effect on price of inframarginal units
  Risk shifting

In spite of risk shifting, g might favor soft budget constraint

- Gambling for i's resurrection

Ex Ante: Comments

g may favor soft budget constraint

- Here, because g starts out already exposed (not really "ex ante")

  Risk and social losses shifted from g to i

  Interesting

How to address risk shifting?

- Forbid lending
- Tax lending
  Could analyze "macroprudential" measures
  Interesting

But hard to analyze in this model because …

Why does i issue debt?

- No gains from trade, so forbidding lending is first best
- Here, pure rent seeking

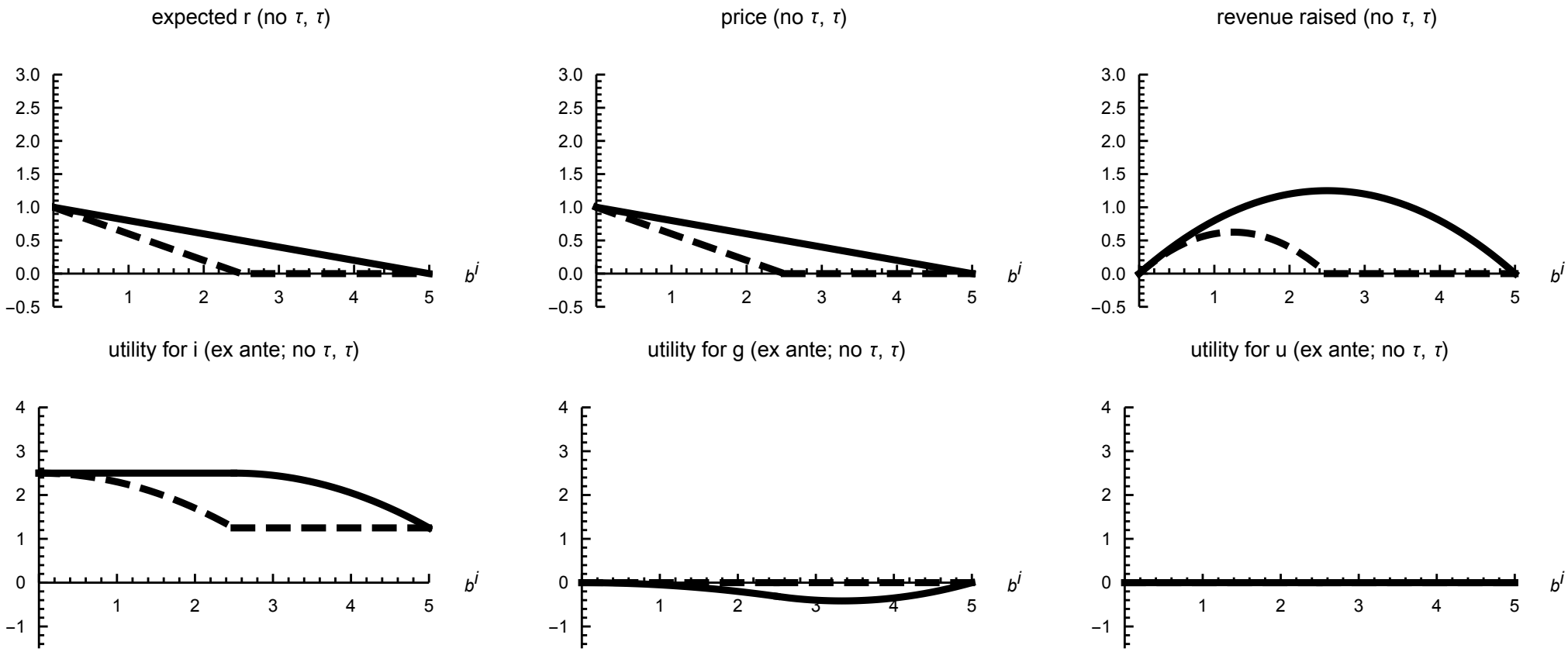

Figure 5: $\alpha^{i,u} = 0.5, \alpha^{i,g} = 0.5, \kappa = 0.0, \xi = 0.0$

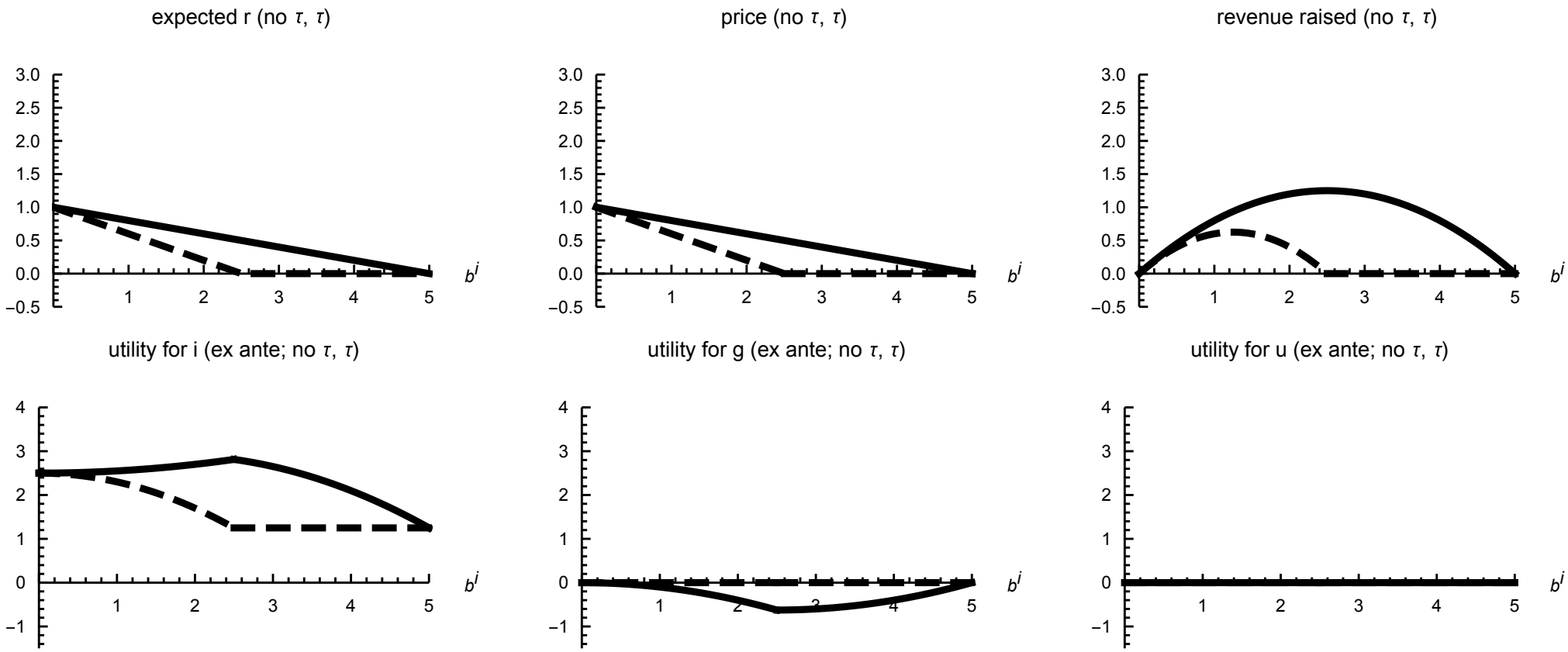

Figure 6: $\alpha^{i,u} = 0.5, \alpha^{i,g} = 0.5, \kappa = 0.0, \xi = 1.0$

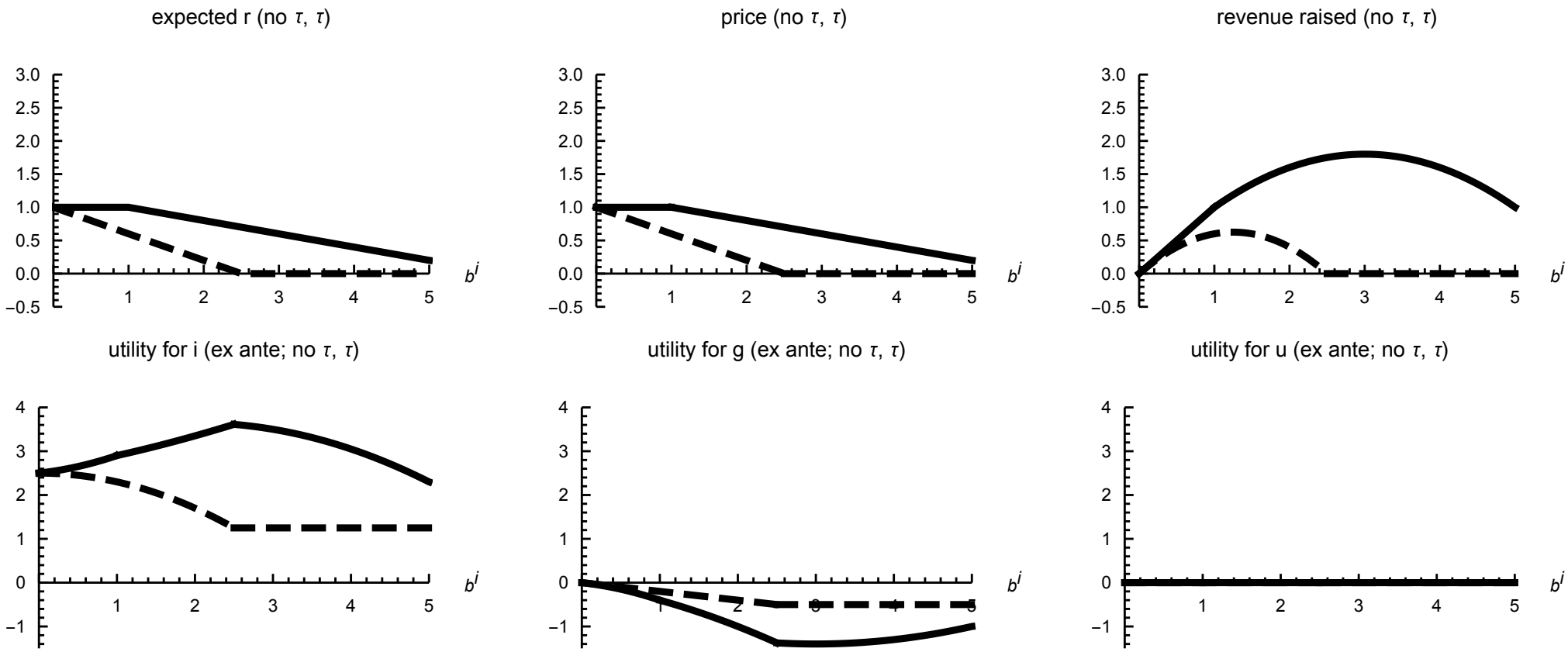

Figure 7: $\alpha^{i,u} = 0.5, \alpha^{i,g} = 0.5, \kappa = 0.5, \xi = 1.0$

Why does i issue debt (ctd.)?

- Want motive for lending to analyze cost of macropru in g Concavity?
- But then transfers in both directions ex post?

How do lenders respond to regulation?

- Can they increase κ (unhelpful)?
- Or Φ (helpful)?
- Can they render κ, Φ state contingent (helpful)?

Further Comments

Data (Greece) vs model

- Relate CACs post 2012 to $\rho \uparrow$?
- Debt purchases: Initially by banks, later by EU (Greece did not choose b on its own)
- Greece's surplus share after restructuring exceeded zero

ECB and monetization

- Another paper
- Inflation costlier than transfers?
- Country specific inflation costs? As a bargaining chip?

Minor comments

- Simplify
  E.g., drop λ stuff, start with αs right away
- Gambling for resurrection with long maturities?
- What prevents transfers in other direction?

Conclusion

Model explains "Northern view"

Assumes "Southern view"

Wanted: Ex ante policy intervention to correct soft budget constraint